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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 000858

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SUBJECT: EUR DAS BRYZA AND AZERBAIJANI PRESIDENT ALIYEV
DISCUSS ENERGY, REGIONAL COOPERATION AND NAGORNO-KARABAKH

Classified By: CHARGE D'AFFAIRES JASON P. HYLAND PER 1.4 (B,D).

11. (C) SUMMARY. EUR DAS Matt Bryza met with Azerbaijani President Ilham Aliyev June 6 to discuss Azerbaijan's growing role as energy supplier, its regional relations and Nagorno-Karabakh. Aliyev expressed strong and unambiguous support for the U.S. "Southern Corridor" Strategy to help Europe diversify its energy supplies with Azerbaijan gas. Aliyev told Bryza that he saw an emerging dynamic of regional organizations, GUAM and the Black Sea Forum, as contributing to positive regional development. Aliyev discussed Azerbaijan's strong ties with Georgia and the importance to engage with Turkey. DAS Bryza recognized progress in Azerbaijan's May re-run parliamentary elections and highlighted the need for Azerbaijan to strengthen its democratic institutions and to build on its regional cooperation efforts. President Aliyev briefed Bryza on the GOAJ's discussions with BP on the ACG deep gas project and outlined Azerbaijan's growing gas resources. Aliyev stated that Azerbaijan and Kazakhstan would sign the IGA for incorporating Kazakhstan's oil into BTC in June in Kazakhstan. DAS Bryza briefed on the U.S. efforts to facilitate Azerbaijani gas reaching Europe, noting that Greece and Italy are interested. President Aliyev stated that the GOAJ would send government energy representatives to Greece and Italy to explore opportunities. Aliyev requested that the U.S. provide strong political support to Azerbaijan's efforts to send gas to Europe with a focus on helping countries and companies achieve concrete results rather than on public statements that might anger Russia. Turning to N-K, Aliyev told Bryza that if Armenia agrees to return five regions immediately to Azerbaijan and sets a timetable to return two additional regions, Azerbaijan is prepared to agree on all other outstanding issues. Aliyev stated that at the Bucharest meeting Azerbaijan had offered USD 100 million or more of economic and social development assistance to the N-K region if a deal were reached. END SUMMARY.

12. (C) Deputy Assistant Secretary for Europe and Eurasia Matt Bryza, accompanied by Charge, S/P's Hellman, and notetaker, met with President Ilham Aliyev June 6 to discuss Azerbaijan's growing regional energy role, regional relations and Nagorno-Karabakh. Commenting on Aliyev's recent trip to Washington, Bryza said that the trip was a success and that Aliyev had charmed his interlocutors, noting that Washington had felt the warmth of Aliyev's friendship. Bryza noted some progress in the recent re-run elections and Azerbaijan's general trend toward political and economic modernization. Aliyev told DAS Bryza that there had been a more open atmosphere for the May parliamentary elections and not as

much "nervousness" compared with November elections, calling them "better." He added that Azerbaijan's political development was moving forward. Bryza replied that it was crucial for these developments to continue and strengthen.

GOAJ, REGIONAL COOPERATION AND NEIGHBORS

13. (C) Aliyev told Bryza that the recent GUAM summit and the June 5 Black Sea Forum for Dialogue and Partnership Summit in Bucharest signaled a "new stage" in regional political, economic and energy cooperation. Aliyev noted that from these two events there was a regional development theme emerging that created a useful dynamic between GUAM and the Black Sea meetings, noting that the groups' goal coincide. Aliyev stated that he saw the Black Sea and Caspian Sea regions as one broad region. Noting the region's "positive teamwork" with the U.S. on regional cooperation, Aliyev said this teamwork should continue with the Baku-Tbilisi-Ceyhan and Shah Deniz gas projects.

14. (C) Bryza noted the importance of Azerbaijan's strategic alliance with Georgia and the solidifying of the East-West Energy Corridor. Aliyev agreed and added that initially Georgian President Saakashvili had balked at such an arrangement feeling that it was a remnant of former President Shevardnadze's government. Recently, however, Saakashvili had come to realize that relations with Azerbaijan were key, noting that Azerbaijan had assisted Georgia in January when its supply of natural gas from Russia had been interrupted by a pipeline explosion. Aliyev said Turkey needed to provide Georgia with its excess natural gas, adding that Turkey had plenty of additional gas supplies. Aliyev indicated that

BAKU 00000858 002 OF 004

Azerbaijan and Georgia's close relations mean that other regional allies, such as Turkey, will also benefit.

15. (C) Aliyev told Bryza that Turkey is trying to leverage its regional economic and political importance with its accession dialogue with the European Union. In addition, he said that Kazakhstan is looking for alternative routes to export its oil and gas and Russia is looking to improve its relations with the G-8. Aliyev opined that as the political, economic and social infrastructure between the regional countries grow, more countries will look to join. He added that Azerbaijan is working to create this environment of regional cooperation.

AZERBAIJAN-KAZAKHSTAN IGA

16. (C) Aliyev told DAS Bryza that Kazakhstan is ready to sign the Inter-Government Agreement (IGA) with Azerbaijan possibly as early as June in Kazakhstan. According to Aliyev, the Kazakh negotiator is calling the GOAJ daily to push the agreement and negotiations along faster. Noting that the two governments had been unable to finalize and sign the IGA in 2005, Aliyev said that events, projects and environment had changed and that the setting was ready for finalization. Aliyev stated that since both Azerbaijan and Kazakhstan's negotiating team had changed the negotiations had taken longer than expected. Bryza told Aliyev that Azerbaijan needed to ensure that the IGA was not so streamlined that it lacked key elements required to provide investor confidence. Aliyev told Bryza that Minister of Energy and Industry Natik Aliyev and Finance Minister Samir Sharifov were the GOAJ's key energy decision-makers, and pledged to look into whether the IGA retained necessary commercial elements.

AZERBAIJAN'S GROWING ENERGY ROLE

17. (C) Aliyev told Bryza that Azerbaijan is looking to expand Shah Deniz full field production by 2012 to ensure Azerbaijan can fulfill its domestic gas demand, as well as that of

Georgia, and still fill the Turkey-Greece-Italy interconnector. DAS Bryza asked Aliyev about the ACG deep gas project and the possibilities of accelerating the project. Aliyev noted that Azerbaijan is ready to focus on the deep gas project, but that it needed "fair conditions" from BP and a "new model" for joint Azerbaijan-energy company relations. According to Aliyev, unlike previous Production Sharing Agreements between Azerbaijan's state oil company, SOCAR, and BP, the deep gas project required that SOCAR take a larger share of the joint agreement. Aliyev stated that SOCAR should have a 50 percent stake rather than 10 percent stake as in other previous PSAs with international energy companies.

18. (C) In addition, Aliyev told Bryza that BP was reneging on its original commitment to provide Azerbaijan with 3 bcm from the deep gas project now that the GOAJ wanted to obtain a better production sharing agreement. BP now planned to re-inject the gas into the field, angering the GOAJ. Aliyev stated that without the deep gas Azerbaijan would have a deficit of gas in this coming winter and may have to purchase additional supplies from Russia or create it from oil stocks to make up the difference. Aliyev also stated that BP needed to act like a "good partner," adding cryptically that Azerbaijan could invite other companies to work the deep gas field.

19. (C) Aliyev told Bryza that Azerbaijan does not need to exhaust its natural gas reserves since with its Shah Deniz field production it will have sufficient for domestic consumption. Aliyev recognized the sensitive political dynamic of this approach and added that Azerbaijan needed greater cooperation and engagement with the U.S. and EU. Beyond the deep gas issue, Aliyev noted that the agreed upon natural gas price with BP was too low with a maximum price ceiling of USD 120 and that the GOAJ would need to renegotiate the price with BP.

AZERBAIJANI GAS TO EUROPE

10. (C) DAS Bryza told Aliyev that the U.S. is actively working with the European Union to create market access for

BAKU 00000858 003 OF 004

Azerbaijani natural gas, noting that this issue will be part of the U.S.-EU summit. Bryza briefed on his numerous trips to Europe, including to Greece, to discuss the energy issue. He noted that both Greece and Italy are under tremendous pressure to sign long-term gas agreements with Gazprom, although both countries have indicated that they want Azerbaijani gas.

11. (C) Bryza noted that some of the difficulties in Greece of accepting Azerbaijani gas may be due to the Azerbaijan flight to Northern Cyprus in 2005. Bryza explained that this flight has annoyed many in the Greek government and may be contributing to Azerbaijan's difficulties in meeting with the government to discuss possible gas sales. Aliyev indicated that Azerbaijan and Greece maintain good relations and that he was unaware that the Azerbaijani Embassy in Athens was having difficulty arranging meeting with Greek energy officials. Aliyev characterized any Greek anti-Azerbaijan reaction to the Cyprus flight as an "overreaction" and "a silly issue." Bryza suggested that Aliyev or Foreign Minister Mammadyarov meet with the Greek Ambassador to Azerbaijan to resolve the issue and engage in additional dialogue.

12. (C) Aliyev stated that Greece needs Azerbaijani gas and that by 2007 Azerbaijan will produce enough additional gas to bring supplies to Greece through Turkey. Aliyev noted that the U.S. needed to talk with Turkey about its natural gas quota, noting that Turkey could refuse to accept some of its Azerbaijani gas that could then go to Georgia or Greece. Aliyev told Bryza that Russia would "punish" Azerbaijan for

selling gas to Europe, a large Gazprom market, adding that Azerbaijan still purchases some gas from Russia which could be cutoff.

¶13. (C) In order to protect Azerbaijan's energy supplies, Aliyev told Bryza that he ordered SOCAR to increase its gas production by 1 bcm by 2007. He explained that Azerbaijan currently imports 4.5 bcm of gas from Russia and obtains an additional 2.5 bcm from the Shah Deniz field. The additional 1 bcm from SOCAR's domestic production could give Azerbaijan an additional energy cushion. Aliyev added that if Turkey refused some of its gas shipments, additional gas quantities in 2007 could be sent to Georgia (approximately 1 bcm), Azerbaijan (700 mcm) and possibly to Greece. Continuing on this theme, Aliyev stated once Azerbaijan begins sending gas to other regions, including Europe, Kazakhstan will become interested and want to join also. Aliyev indicated that by 2008 Shah Deniz gas production should reach 8.5 bcm. Aliyev affirmed that production at Shah Deniz could expand to as much as 20 bcm by 2012-13 and to 50 bcm in 2015.

¶14. (C) Aliyev asked DAS Bryza to talk with the Turks to encourage them to allow commercially attractive transit arrangements and not try to transform State pipeline company BOTAS into a monopoly like Gazprom. Bryza noted that he would talk with the Turkish officials stressing the U.S.-Turkey strategic partnership. He urged Aliyev, however, to reach out and engage with PM Erdogan or President Sezer. Aliyev indicated that Sezer was not the best point of contact on this issue and that he would talk with Erdogan. Aliyev also said the Turks were attempting to please many partners, including Russia, the EU and domestic interests. Bryza also noted that he would be meeting with the Turkish official during his visit in Baku and would also raise these issues.

¶15. (C) In order to improve Azerbaijan's presence in the European energy market, Bryza presented Aliyev with the concept of SOCAR investing in mid and downstream operations in Greece and Italy. This investment could solidify the Greece-Azerbaijan link and improve the chances of a long-term sales and purchase agreement. Aliyev agreed with the idea and told Bryza that we would dispatch two teams from the GOAJ to travel to Greece and Italy to explore these and all aspects of concluding necessary agreements to send Azeri gas to Europe. Aliyev also stated that it was a good opportunity since Azerbaijan had extra money that it could invest in different ventures.

AZERBAIJAN-RUSSIA ENERGY RELATIONS

¶16. (C) DAS Bryza told President Aliyev that the U.S. wants Azerbaijan to be deeply embedded in the West and the

BAKU 00000858 004 OF 004

Euroatlantic family. On regional energy issues, Bryza noted that the U.S. and Azerbaijan were pulling in the same direction. To this, Aliyev noted that time was critical and that it was not wise to irritate Russia. Aliyev noted that the Government of Russia did a poor job of interagency coordination and that by the time it realizes that Azerbaijan is sending gas to Europe, it will be too late. He told Bryza that initially Russia had complained about BTC but that once it was completed the Russians dropped the issue, insinuating that the same would occur with Azerbaijan's efforts to send gas to Europe. For this reason, Aliyev requested that the U.S. help achieve facts on the ground rather than rhetoric that might tip off and anger Russia.

Nagorno-Karabakh

¶17. (C) Bryza told Aliyev that in the coming weeks he will assume OSCE Minsk Group Co-Chair responsibilities from Ambassador Mann. Aliyev welcomed the move (though he highly valued Mann's contributions) and told Bryza that the meetings

with the Armenians in Bucharest had been more productive than Rambouillet. Despite the fact that the negotiations had been more flexible, the outcome was the same. Aliyev told Bryza that if five regions are returned immediately to Azerbaijan and two additional regions are returned on a set timetable, Azerbaijan is prepared to agree on all other outstanding issues. He noted that the Armenian president stated that he could not sell this kind of peace deal. Aliyev said that he was in the same situation if he did not obtain all the occupied territories.

¶18. (C) Aliyev stated that at the Bucharest meeting Azerbaijan had offered USD 100 million or more of economic and social development assistance to the N-K region if a deal was reached with Armenia. Aliyev continued that Azerbaijan will always have money and that Karabakh is the number one issue for the country. He said that Armenia received no benefit from N-K and that Azerbaijan would use its money to assist the region or buy more weapons. He added that Azerbaijan wanted to assist the region economically. Aliyev said using money to obtain the territory would be difficult but that he could sell it to the public. Aliyev speculated that Armenian President Kocharian was interested in pushing back any agreement on N-K until the elections in 2008 so he could benefit politically. He stated that after Rambouillet, Azerbaijan had made concessions and Armenia had made none. Finally he stated that the parties will find a solution to the N-K problem and that Azerbaijan was not in a rush.

¶19. (C) COMMENT: In this meeting, President Aliyev made the clearest and most emphatic statement of support for our "Southern Corridor" Strategy to date. This is a very encouraging development.

¶20. (U) EUR DAS Bryza cleared this cable.
HYLAND